INTERPRETATION STATEMENT

# Non-cash dividends

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This Interpretation Statement considers when a transfer of company value from a company to a shareholder is treated as a dividend for tax purposes. It focuses on the types of non-cash transactions that are often entered into between small and medium-sized companies and their shareholders.

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

**UPDATES AND REPLACES**

This item updates and replaces "Deemed dividends", *Public Information Bulletin* 125 (March 1984): 6.

# Contents



# Introduction

1. This Interpretation Statement considers when a non-cash transfer of company value from a company to a shareholder is treated as a dividend for tax purposes (often referred to as a deemed dividend). It focuses on the types of transactions that are entered into between small and medium-sized companies and their shareholders.

2. The Interpretation Statement first discusses the general rules for determining when a non-cash dividend will arise and provides some simple examples to assist readers to

understand the concepts. It then summarises the more complex rules for calculating the amount of a dividend in different situations, also with examples.

3. This Interpretation Statement is intended to raise awareness of when simple non-cash transactions will give rise to dividends. It does not consider the more complex rules relating to share repurchases, statutory producer boards, co-operative companies, foreign unit trusts, superannuation schemes, share-lending arrangements or emigrating companies. It also does not consider the rules relating to dividends arising within groups of companies.

4. In addition, the payment of a cash or non-cash dividend gives rise to a number of administrative obligations, including disclosures, requirements to provide dividend statements and withholding tax obligations. These obligations are not discussed in this Interpretation Statement. However, taxpayers should be aware that these obligations exist and seek further advice on how to comply with them.

## Interaction with other rules

5. Non-cash transfers of value from a company to a person can arise for a number of reasons. In particular, a company may transfer value to a person because:

   - they are, or are associated with, an employee of the company, as compensation for the employee's services; or
   - they are, or are associated with, a shareholder of the company.

   In the case of small and medium sized enterprises it is often the case that people involved in the company are both employees and shareholders.

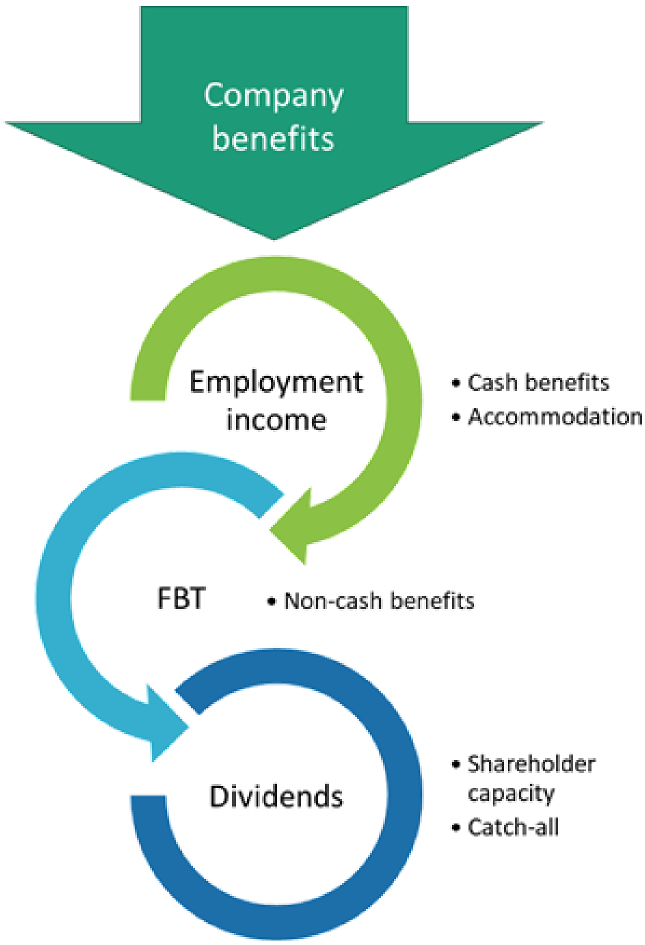
6. Because transfers of value can be caused for various reasons, the first question to ask in determining the tax treatment of the transfer is – what is the reason for the transfer?

7. Where the transfer of value is caused by an employment relationship, the transfer will usually be taxed either as employment income, or as a fringe benefit. Employment income is usually paid in cash but can also include some non-cash benefits, including the provision of accommodation. This is discussed in more detail from [50]. A fringe benefit is a non-cash benefit an employer provides to an employee in connection with their employment. This is discussed in more detail from [54].

8. Where a transfer of value is caused by an employment relationship it will, usually, not be a dividend. However, in some cases where the non-cash benefit is provided to an employee who is also a shareholder, the fringe benefit rules either require that the benefit be treated as a dividend and not as a fringe benefit, or allow the company to choose whether to treat the benefit as a fringe benefit or a dividend. These situations are discussed at [57].

9. Where the transfer of value is not caused by an employment relationship, or the fringe benefit rules allow the company to choose, or require the company to treat the transfer as a dividend, the dividend rules become relevant. These situations are the focus of this Interpretation Statement.

10. This process of determining which tax rules apply to a transfer of value is illustrated by the following graphic:



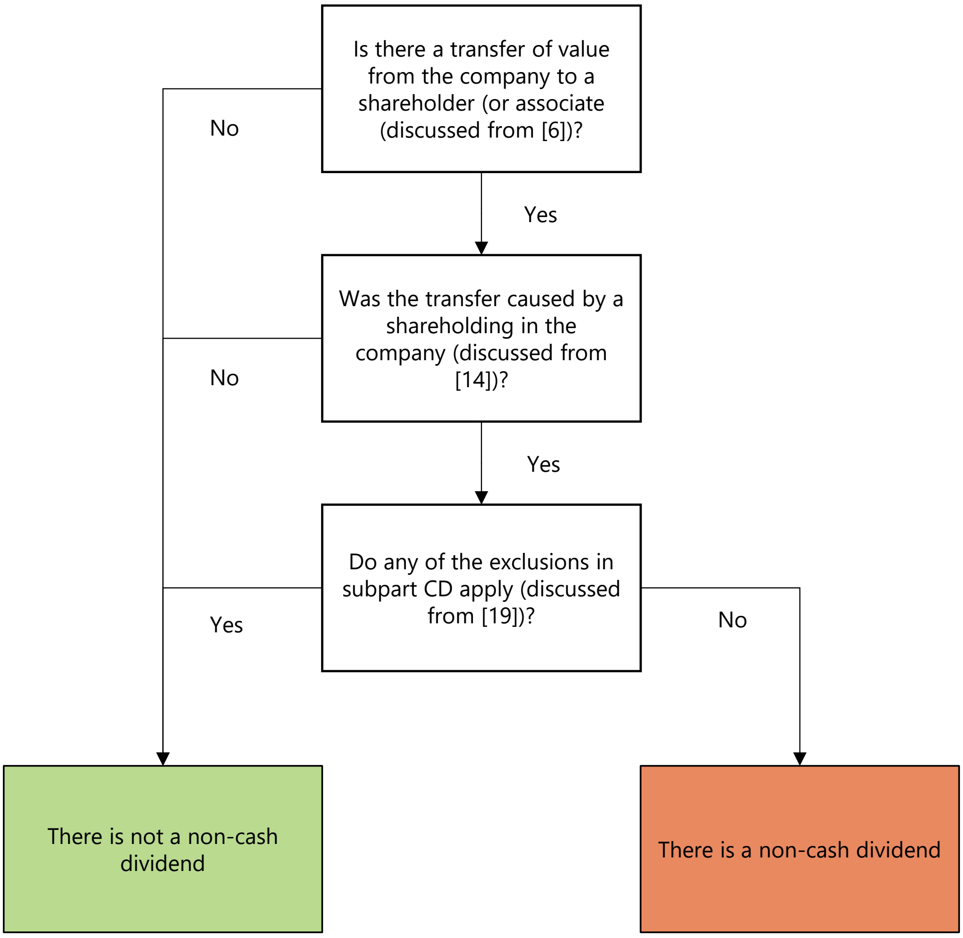

# Amounts that are a dividend

11. Subpart CD describes what is and is not a dividend. Under s CD 4, a dividend is a transfer of company value from a company to a person, if:

- the cause of the transfer is a shareholding in the company; and
- none of the exclusions in subpart CD apply.

12. This statement focuses on the provision of non-cash dividends.

13. The following flow-chart illustrates how to determine whether a non-cash dividend has been paid:




## Transfers of company value

14. Section CD 5 defines a "transfer of company value" for the purpose of the dividend rules in subpart CD. Under s CD 5(1) a transfer of company value from a company to a person will occur when:

- the company provides money or money's worth to the person; and
- if the person provides money or money's worth to the company in exchange, the market value of what the company provides is more than the market value of what the person provides.

15. Case law indicates that the expression "money or money's worth" requires that a benefit be in money or be convertible into money, either directly or indirectly (*Tennant v Smith* (1892) 3 TC 158 (HL), *Stagg v CIR* [1959] NZLR 1,252 (HC), *Abbott v Philbin (Inspector of Taxes)* [1960] 2 All ER 763 (HL), *Heaton (Inspector of Taxes) v Bell* [1969] 2 All ER 70 (HL) and *Dawson v CIR* (1978) 3 NZTC 61,252 (SC)). A benefit will be directly convertible into money where the benefit can be exchanged for a monetary equivalent (*Dawson* at 61,257). For example, shares that are capable of being sold for money will

be money's worth. Non-cash dividends are transfers of money's worth from a company to a shareholder.

16. The remainder of s CD 5 clarifies whether money's worth arises in four situations.

17. First, money's worth **is** provided by a company to a person where the person is released from repaying a debt to the company, either by agreement or by operation of law (unless the company and the person are part of the same wholly-owned group) (s CD 5(2)). This means a dividend may arise if a company releases a shareholder from repaying a debt.

18. Secondly, money's worth **is not** provided by a person to a company on the cancellation of a share the person holds or the cancellation of the person's rights as a shareholder (s CD 5(2B)). This section means that in cases where a transfer of money or money's worth from the company to a shareholder occurs on the cancellation of a share, the shareholder is deemed to provide nothing in return. This may be a dividend.

19. Thirdly, money's worth **is not** provided by a company to a person where the company provides services to the person (s CD 5(3)). This means a dividend will not arise simply because a company provides services that it ordinarily provides as part of its business to a shareholder for less than market consideration. "Services" are anything that is not goods, money or a chose in action (a chose in action includes the right to use property).

20. And fourthly, money's worth **is** provided by a company to a person if the company is a close company and the company provides services consisting of the benefit of expenditure by the company to the person (s CD 5(4)). This means, where a company is a close company and the company incurs expenditure on behalf of a shareholder, a dividend may arise. A close company is generally a company with five or fewer natural persons or trustees whose total voting interest in the company is more than 50% (treating all natural persons associated at the time as one person).

21. Example 1 to Example 5 illustrate when a transfer of company value occurs under the provisions discussed above. The examples show when a transfer of company value occurs. How the transfer of company value is taxed (for example, whether as a dividend or under the fringe benefit tax (FBT) regime) is considered below.

### Example 1 – Simple transfer of company value

> Hannah is a shareholder in Hannah's Bananas Ltd. In the 2020 income year, Hannah's Bananas Ltd provides Hannah with a lot of fresh bananas.
>
> Hannah's Bananas Ltd has provided money's worth to Hannah. Hannah has not provided any money or money's worth to Hannah's Bananas Ltd. Therefore, there is a transfer of company value from Hannah's Bananas Ltd to Hannah.

### Example 2 – Release from repayment of a debt

Ike is a shareholder in Ike's Bikes Ltd. Ike's current account is overdrawn by $100. In the 2021 income year, Ike's Bikes Ltd agrees to release Ike from having to repay the current account debt.

By releasing Ike from the obligation to repay the current account debt, Ike's Bikes Ltd has provided money's worth to Ike under s CD 5(2). Ike has not provided any money or money's worth to Ike's Bikes Ltd. Therefore, there is a transfer of company value from Ike's Bikes Ltd to Ike.

### Example 3 – Cancellation of shares

Fiona is a shareholder in Fiona's Feijoas Ltd. Fiona's Feijoas Ltd buys back Fiona's shares for $100.

In buying back Fiona's shares, Fiona's Feijoas Ltd has transferred value to Fiona. Under s CD 5(2B), Fiona has not transferred any value to Fiona's Feijoas Ltd by giving up her interest in the shares. Therefore, Fiona's Feijoas Ltd has transferred value to Fiona.

**Note:** This example does not consider whether the share repurchase will give rise to a dividend. The rules for determining whether a share repurchase will result in a dividend are in ss CD 22 to CD 25. Generally, an amount will not be a dividend to the extent to which it is equal to or less than the available subscribed capital per share, provided various bright-line tests are met and the payment is not in lieu of a dividend.

### Example 4 – Provision of services

Cam is a shareholder in Cam's Coms Ltd, which is a widely held company. Cam's Coms Ltd provides telecommunication services. Cam's Coms Ltd provides Cam its telecommunication services for free.

Under s CD 5(3), the provision of the telecommunication services by Cam's Coms Ltd to Cam is not money's worth. Therefore, the provision of these services at an undervalue will not give rise to a transfer of company value.

### Example 5 – Provision of services in a close company

Mel is a shareholder in Mel's Mowing Ltd. Mel's Mowing Ltd is a close company. Mel's Mowing Ltd pays for Mel's personal car to be cleaned at a cost of $50.

By incurring expenditure that gives rise to a benefit to Mel, Mel's Mowing Ltd has provided money's worth to Mel under s CD 5(4). Therefore, the expenditure on cleaning Mel's personal car gives rise to a transfer of company value from Mel's Mowing Ltd to Mel.

## Caused by a shareholding

22. Under s CD 6, a transfer of company value will be caused by a shareholding where:

- the recipient is a shareholder in the company or is associated with a shareholder in the company; and
- the company makes the transfer because of that shareholding.

23. One indication that a transfer is caused by a shareholding is if the terms of the arrangement that results in the transfer are different from the terms on which the company would enter into a similar arrangement if no shareholding were involved (s CD 6(2), *Case V9* (2001) 20 NZTC, 10,101 (TRA) and *Campbell v CIR* [1968] NZLR 1 (HC)).

24. As discussed above, if the transfer of value is caused by an employment relationship and is not caused by the person's shareholding in the company, then it will not be a dividend. Instead, the benefit will be subject to the employment income or fringe benefit rules. Where a person is both a shareholder and an employee, one indication that the transfer of value is **not** caused by the shareholding may be that the person is the only shareholder who received a transfer of value.

25. The following examples explain when a dividend will be caused by a shareholding.

### Example 6 – Dividend caused by a shareholding – distribution of goods

Grant is a shareholder in Grant's Plants Ltd. He is not an employee. During the 2020 income year, Grant acquires an inner-city apartment and as part of furnishing it, uses an extensive selection of plants from Grant's Plants Ltd.

The distribution of plants is a transfer of company value from Grant's Plants Ltd to Grant. Grant's Plants Ltd would not have given its plants to Grant if Grant was not a shareholder in the company. Therefore, the transfer of company value is caused by the shareholding.

### Example 7 – Dividend caused by a shareholding – private use of assets

Pat is a shareholder in Pat's Pears Ltd. Pat's Pears Ltd allows Pat to use one of its vehicles for his private purposes (Pat is not an employee of Pat's Pears Limited). Pat does not make any payment to Pat's Pears Ltd in exchange for the use of the vehicle.

Pat's Pears Ltd has transferred value to Pat by allowing him to use one of its vehicles without requiring any payment in exchange. Pat's Pears Ltd would not allow a person unconnected with the company to use its vehicles. Pat's only connection with the company is his shareholding. Therefore, the transfer of company value is caused by the shareholding.

### Example 8 – Dividend not caused by a shareholding

Linda is a shareholder in Linda's Lamingtons Ltd. She is not an employee. Linda's Lamingtons Ltd has a sale and sells its products at a discounted price. Linda purchases some discounted products in the sale.

Linda's Lamingtons Ltd has provided money's worth to Linda because it has sold Linda goods at an undervalue. However, the transfer of value is not caused by the shareholding. This is because the same discounts are offered to all of Linda's Lamingtons Ltd's customers.

### Example 9 – Dividend paid to an associate

Angel's Family Trust owns all the shares in Angel's Antiques Ltd. Angel is a settlor, trustee and beneficiary of Angel's Family Trust. Angel is not an employee of Angel's Antiques Ltd. Angel's Antiques Ltd gives Angel a valuable antique from its store.

The gift of the valuable antique is a transfer of company value from Angel's Antiques Ltd to Angel. While Angel is not a shareholder of Angel's Antiques Ltd, she is associated with the sole shareholder, Angel's Family Trust. Angel's Antiques Ltd would not have given Angel the antique if she was not associated with a shareholder. Therefore, the transfer of company value is caused by a shareholding.

## Specific transactions that are treated as dividends

26. As well as defining a dividend in general terms, subpart CD also specifies types of transactions that will give rise to dividends:

- **Making a bonus issue in lieu** (s CD 7) – being an arrangement where shareholders of a company are given an election as to whether to receive a bonus issue of shares for no consideration, or money or other money's worth.
- **Issuing a share under a profit distribution plan** (s CD 7B) – being a scheme where a company notifies shareholders that shares are to be issued and gives the shareholders an option to have some or all of the shares repurchased by the company (other than the issue of shares under an employee share scheme or a share repurchase scheme).
- **Making a taxable bonus issue** (s CD 8) – being a bonus issue fully paid from reserves that the company chooses to treat as a dividend.
- **Dividends arising under specific avoidance provisions** (s CD 11) – being:
    - Where shares are disposed of in substitution for a dividend (that is, dividend stripping arrangements) (s GB 1);
    - Where the company employs a relative of a director or shareholder to provide services, and the Commissioner considers the income payable to the relative is excessive (s GB 23); or
    - Where a close company provides remuneration for services to a shareholder, director, or relative of a shareholder or director who is not an adult employed substantially full-time in the business who participates in

the management or administration of the company, and the Commissioner considers the remuneration is excessive (s GB 25).

Sections GB 23 and GB 25 concerning excessive payments are considered in "QB 14/09: Income tax – meaning of 'excessive remuneration' and 'excessive profits or losses' paid or allocated to relatives, partners, shareholders or directors", *Tax Information Bulletin* Vol 26, No 9 (1 October 2014): 22.

- **Providing non-cash benefits to shareholders (s CD 20)** – being:
  - unclassified benefits provided to employee shareholders that the company chooses to treat as a dividend; and
  - non-cash benefits provided to a non–executive director who is a shareholder of the company.

  The treatment of non-cash benefits that are fringe benefits is discussed from [54].

## Specific transactions that are not treated as dividends

27. The final requirement in determining whether an amount is a dividend is to determine whether the amount is specifically excluded from being a dividend under ss CD 22 to CD 37.

28. This Interpretation Statement does not consider all of the situations in which an amount will not be a dividend. However, in the context of the scenarios covered by this item, the most common exclusion that will apply is the exclusion for a transfer of value that is treated as a fringe benefit (s CD 32), which is discussed further from [54].

29. Subpart CD also confirms that transactions that will not give rise to dividends include:
    - non-taxable bonus issues (s CD 29); and
    - a flat-owning company making residential property available to a person (s CD 31).

30. For completeness, other transactions that also do not give rise to dividends are:
    - share repurchases (ss CD 22 to CD 25).
    - capital distributions on liquidation or emigration (ss CD 26); and
    - transactions within a group of companies (ss CD 27 and CD 28).

31. Further consideration of these provisions is outside the scope of this Interpretation Statement.

# Calculating the amount of a dividend

## General rule

32. Under s CD 38, the amount of a dividend is calculated using the formula:

value from company – value from person

33. The "value from the company" is the market value of the money or money's worth that the company provides to the person. The "value from the person" is the market value of the money or money's worth, if any, that the person provides to the company in exchange. This excludes any amount attributable to holding or giving up rights as a shareholder in the company. This is shown in Example 10.

**Example 10 – Value of the dividend**

Jon is a shareholder in Jon's Scones Ltd. Jon's Scones Ltd has recently replaced one of its ovens. Jon thinks the old oven would be useful in his refurbished farmhouse. Jon takes the oven for his own personal purposes. Jon gives Jon's Scones Ltd $50 for the second-hand oven when its market value is $500.

Jon's Scones Ltd has provided value of $500. Jon has provided value of $50. Therefore, the value of the dividend is $450 (being $500 less $50).

34. Generally, a dividend will be treated as having been paid on the date the transfer of value arises.

## Making property available

35. Specific rules also apply to calculate the amount of a dividend where a company makes property available to a person (s CD 39). A company makes property available to a shareholder when the company allows the shareholder to use property that the company owns for the shareholder's private purposes. As noted at [19], the right to use property is a chose in action and, therefore, is not a "service" as defined. It could be argued that a company provides a "service" to a shareholder by allowing them to use its property, which is excluded from being a transfer of value under s CD 5(3). However, the Commissioner considers the better view is that, by allowing a shareholder to use property that the company owns, the company is providing the shareholder with a right to use property, which is a chose and action, and not a service. This view is more consistent with the fact that the Act includes rules for calculating the amount of a dividend where a shareholder uses a company's property.

36. Under these rules, the amount of the dividend is calculated for each quarter during which the property is made available. The dividend is treated as being paid six months after the end of the company's income year, unless the company gives the shareholder earlier notice of the amount of the dividend.

37. Where the property **is not a loan**, the amount of the dividend for each quarter is the value of the fringe benefit that would arise under the fringe benefit rules if the benefit was provided to an employee. Example 11 illustrates this.

### Example 11 – Making property available

Cath is a shareholder in Cath's Cabin Ltd. Cath is not an employee of Cath's Cabins Ltd. Cath's Cabin Ltd owns a holiday home that it rents out on Airbnb for $400 per night. Cath uses the holiday home for her own personal benefit for three nights. Cath pays $50 per night.

The amount of the dividend is the value of the fringe benefit that would arise under the fringe benefit rules if the benefit was provided to an employee. Under s RD 41, the value of the fringe benefit is the price ordinarily charged by Cath's Cabin Ltd as part of its business. Under s RD 54, the value of the benefit is reduced by the amount Cath paid. Therefore, the amount of the dividend in this example is $1,050 (being $400 less $50 ($350) per night for three nights).

38. Where the property **is a loan**, the amount of the dividend for each quarter can be calculated in two ways. The amount is either the difference between:

- the benchmark rate and the actual amount of interest accruing on the loan; or
- the benchmark rate and the amount of income accruing to the company in the quarter calculated under the yield to maturity method.

39. The "benchmark rate" is the interest calculated for the quarter on the daily balance of the loan calculated as:

- where all amounts are expressed in New Zealand dollars, and the company notifies the Commissioner when it files its tax return, the prescribed rate of interest declared by regulations; or
- where all amounts are expressed in a single currency other than New Zealand dollars, and the company notifies the Commissioner when it files its tax return, the benchmark rate the Commissioner set for that currency (if any); or
- in all other cases, a market rate determined at the end of the quarter for a loan made on the same terms between persons at arm's length.

40. Example 12 shows how a simple dividend is calculated under an interest-free loan.

### Example 12 – Interest-free loan

Kiri is a shareholder in Kiri's Construction Ltd. She is not an employee. Kiri borrows NZ$1,000, interest free, from Kiri's Construction Ltd.

Kiri is deemed to have received a dividend equal to the difference between the benchmark rate and the actual amount of interest accruing on the loan. Kiri decides to rely on the prescribed rate of interest declared by regulation rather than determining what a market value for a loan of this type would be. From 1 July 2020, the prescribed interest rate is 4.5%.

For the quarter 1 July 2020 to 30 September 2020, the amount of the non-cash dividend is:

$$Non - cash\ dividend = Outstanding\ loan\ x\ interest\ rate\ x\ \frac{days\ in\ quarter}{365}$$

$$Non - cash\ dividend = \$1{,}000\ x\ 4.5\%\ x\ \frac{92}{365}$$

$$Non - cash\ dividend = \$11.34$$

41. In calculating the daily balance of the loan, an amount repaid during the tax year is treated as having been applied in repayment of the loan on the later of the start of the company's tax year or the day the loan was made, if:

- the amount is repaid by applying salary, wages, extra pay, dividends or interest payable by the company to the borrower;
- the amount payable by the company is income of the borrower in the tax year or an earlier tax year; and
- the amount payable by the company is payable without any amount of tax being withheld under the PAYE, resident withholding tax or non-resident withholding tax rules, or is a fully imputed dividend.

42. Example 13 shows how the timing rule works for dividends applied in repaying loans.

### Example 13 – Repayment of a loan

Michelle is a shareholder in Michelle's Marvellous Muffins Ltd. During the 2020 income year, Michelle borrows NZ$1,000, interest free, from Michelle's Marvellous Muffins Ltd.

In the same year, Michelle's Marvellous Muffins Ltd pays Michelle a fully imputed dividend of $200 (gross dividend of $277.78 including imputation credits of $77.78) that is applied to repay part of the loan. Because the repayment is made in the same year that the loan was provided, Michelle is treated as having made the repayment on the day the loan was originally made, and any dividend arising from the fact the loan was interest-free will reduce accordingly.

Michelle's Marvellous Muffins Ltd pays Michelle another fully imputed dividend of $200 in the 2022 income year that is also applied to repay part of the loan. Because the repayment is made in the income year after the loan was provided, the repayment is treated as being paid at the start of Michelle's Marvellous Muffin's 2022 tax year.

## Imputation credits

43. A company may attach imputation credits to a dividend when it is paid (s OB 60). This is the case whether the dividend consists of money or money's worth. However, the requirement that imputation credits be attached when the dividend is paid means an ordinary company cannot attach imputation credits retrospectively if it discovers that a non-cash dividend has arisen unintentionally. In determining when a non-cash dividend is paid it may be necessary to have regard to the calculation rules, which specify when a dividend is treated as having been paid in some situations (discussed above from [32]).

44. The benchmark dividend rules will apply where a company pays more than one dividend during any tax year (including a non-cash dividend). Under those rules the first dividend of the year is the benchmark dividend and the imputation ratio of all dividends paid during the year must match the benchmark dividend (s OB 61). This means that if an unimputed non-cash dividend is the first dividend paid in a tax year, no other dividends paid in that year can be imputed.

45. The benchmark dividend rule also requires that any dividend paid after the benchmark dividend that is not imputed at the same rate as the benchmark dividend (including a non-cash dividend), will result in a debit to the imputation credit account (s OB 61(5)). This will occur despite no imputation credits having been attached to the dividend. The debit is calculated based on the highest amount of imputation credits attached to any distribution during the year, such that it will arise whether the unimputed dividend is paid first, or subsequent to a fully imputed dividend.

46. The benchmark dividend rules can, however, be overridden if the company notifies the Commissioner by providing a ratio change declaration (IR 407) before paying any subsequent dividends, stating that the dividend is not part of an arrangement to obtain a tax advantage under ss GB 35 and GB 36 (s OB 61(6)). This declaration must be witnessed by a Justice of the Peace, solicitor, or other person authorised to take a statutory declaration.

# Recovered amounts

47. Calculation rules ensure the treatment of some dividends is reversed if the transaction is reversed. These rules apply where:

- a company recovers a dividend from a shareholder (s CD 40);
- a dividend arises because a person was released from an obligation to repay debt, and the debt is later repaid (s CD 41(1));
- a dividend arises because a close company provided services consisting of the benefit of expenditure by the company to the person and the shareholders believe on reasonable grounds that the expenditure was only for the benefit of the company and the expenditure is later repaid (s CD 41(2));
- a dividend arises because of a difference between the market value of the property provided by or to the company and the consideration paid for it (s CD 42), and:
  - the consideration paid was an amount the company considered was market value having taken reasonable steps to ascertain the market value; and
  - the recipient of the dividend later paid the company:
    - additional consideration to reflect market value; or
    - a refund of any excess consideration paid by the company.

48. In all cases, the Act ensures the recovered dividend and any imputation credits are disregarded for tax purposes, and a refund of any tax paid occurs. This is shown in Example 14.

**Example 14 – Recovered amounts**

Taniela is a shareholder in Taniela's Tables Ltd. Taniela is not an employee of Taniela's Tables Ltd. Taniela's Tables pays a dividend to Taniela. However, after the dividend is paid the directors realise that the solvency test has been breached, and they claw back the dividend.

Due to the clawing back of the dividend, the dividend is reversed under s CD 41.

# Dividends are not deductible

49. No specific provision in part D denies a deduction for a payment that is deemed a dividend to the recipient. However, the payment of a dividend to a shareholder is generally denied deductibility because it does not have any nexus with the derivation

of income or carrying on a business as required by s DA 1. Case law confirms that a distinction exists between the expenses incurred in earning profits, which are deductible, and any post-profit distribution, which is non-deductible (*Mersey Docks and Harbour Board v Lucas* (1883) 8 AC 891, (1883) 2 TC 25 (HL)). Example 15 shows this.

**Example 15 – Deductibility**

Dinesh is a shareholder in Dinesh's Dinners Ltd. Dinesh is not an employee of Dinesh's Dinners Ltd. Dinesh's Dinners Ltd incurs $200 paying Dinesh's private power and phone bills. This payment is discovered in a compliance review of Dinesh's Dinners Ltd a couple of years later.

The $200 of private expenditure that Dinesh's Dinners Ltd paid is treated as a dividend for Dinesh, so the expenditure is not deductible for Dinesh's Dinners Ltd. If a deduction had previously been taken for that expenditure it will be reversed as part of the review.

# Amounts that are not a dividend

## Employment income

50. As discussed above, where a shareholder or an associate of a shareholder is also an employee of the company and receives an amount as payment for services provided, that will not give rise to a dividend. This is because the money or money's worth provided by the company to the person (the payment) is equal to the money or money's worth provided by the person to the company (the services). In addition, even if there is a transfer of value, it will be caused by the employment relationship, and not by the shareholding. This is subject to the avoidance rules for excessive payments made to relatives, shareholders or directors (under s CD 11), discussed at [26] and in QB 14/09.

51. However, while amounts received by an employee are not treated as dividends, they do give rise to income for the employee under s CE 1. Employment income is usually in the form of cash payments. However, it can include some non-cash items. Under s CE 1, an amount derived in connection with employment or service is income if it is:

- salary, wages or an allowance, bonus, extra pay or gratuity;
- the value of accommodation (including accommodation allowances, payments or reimbursements) provided to a person when it is provided in relation to employment or service (ss CE 1B to CE 1E);

- expenditure on account of an employee, being a payment made by an employer relating to expenditure incurred by an employee or to be incurred by an employee (s CE 5);
- a benefit received under an employee share scheme (as described in s CE 2);
- director's fees;
- compensation for loss of employment or services; or
- any other benefit in money.

52. Section CD 32 also confirms that the value of accommodation provided to a person in relation to employment or service which is employment income is not a dividend.

53. The amount a company incurs paying employment income will usually be a cost incurred in deriving assessable income or in the course of carrying on a business for the purpose of deriving assessable income, such that the payments will be deductible under s DA 1. However, where amounts are paid to employees who are working on a capital project, the payments may not be deductible (*Christchurch Press Co Ltd v CIR* (1993) 15 NZTC 10,206). Section DB 1 confirms that the company is also allowed a deduction for PAYE paid in relation to employment income. Example 16 shows how employment income is treated differently from dividends.

**Example 16 – Employment income**

Dani is a shareholder and an employee of Dani's Doughnuts Ltd. Dani receives $2,000 per month from Dani's Doughnuts Ltd.

This payment is compensation for Dani's services to Dani Doughnuts Ltd. The money transferred by Dani's Doughnuts Ltd to Dani is equal to the money's worth provided by Dani to Dani's Doughnuts Ltd. Therefore, the payment is not a dividend. However, it will be taxable employment income for Dani and will be deductible for Dani's Doughnuts Ltd.

## Fringe benefits

54. Under s CD 32, a benefit provided to an employee is not a dividend if it is a fringe benefit subject to FBT.

55. A "fringe benefit" is a benefit an employer provides to an employee in connection with their employment that is (s CX 2):

- the private use of a motor vehicle (s CX 6);
- subsidised transport (s CX 9);

- an employment-related loan (s CX 10);
- a service provided to members of Parliament (s CX 12);
- a contribution to a superannuation scheme (s CX 13), sickness, accident or death benefit fund (s CX 14), funeral trust (s CX 15), or life or health insurance (s CX 16); or
- an unclassified benefit, being a benefit subject to FBT other than those listed above.

56. A fringe benefit is excluded income of the employee (s CX 3) and is, instead, subject to FBT under s RD 26.

57. However, if a company provides a non-cash benefit to an employee who holds shares in the company, other than a non–executive director, the company may choose to treat the benefit as a fringe benefit or a dividend (s CX 17). Section CX 17 will apply only if the benefit:

    - would have given rise to a dividend (that is, the benefit related to the shareholding); and
    - is an unclassified benefit.

58. Section CX 17 will not apply if the fringe benefit arises from the private use of asset which is subject to the mixed-use asset rules in subpart DG. If that is the case, the company must choose to treat the benefit as a dividend and not as a fringe benefit.

59. In addition, if a company provides a benefit to a person who is associated with an employee and with a shareholder in the company, and that benefit would have been a dividend if provided to the shareholder, the benefit is subject to FBT and is not treated as being a dividend (s CX 18).

60. As for other employment income, the amount a company incurs in providing benefits to employees will usually be a cost incurred in deriving assessable income or in the course of carrying on a business for the purpose of deriving assessable income such that the payments will be deductible under s DA 1. Section DB 1 confirms that the company is also allowed a deduction for FBT paid on fringe benefits.

61. Example 17 and Example 18 illustrate when fringe benefits will arise.

### Example 17 – Fringe benefit

Noah is a shareholder and an employee of Noah's Needles Ltd. Noah uses a car owned by Noah's Needles Ltd for his private purposes.

Because Noah is an employee of Noah's Needles Ltd, the private use of a company vehicle will give rise to a fringe benefit rather than a dividend. Because the provision of a motor vehicle is not an unclassified benefit, Noah's Needles Ltd cannot choose to elect that the amount be treated as a non-cash dividend under s CX 17. Therefore, Noah's Needles Ltd must pay FBT on the private use of the vehicle.

Noah's Needles Ltd will be entitled to deduct the FBT paid.

### Example 18 – Unclassified benefits

Jaya is a shareholder and an employee of Jaya's Jet Skis Ltd. Jaya regularly uses Jaya's Jet Skis Ltd's jet skis for her own private use.

Because Jaya is an employee of Jaya's Jet Skis Ltd, the private use of the company's property will give rise to a fringe benefit. The use of the jet skis is an unclassified benefit. Therefore, Jaya's Jet Skis Ltd can choose to treat the private use as a dividend or a fringe benefit by either including it in their FBT return for the relevant period, or complying with the withholding and other obligations that arise from paying a dividend.

# Look-through companies

62. Shareholders (or persons with an "effective look-through interest" (see s HB 1(5) and YA 1)) in a look-through company (LTC) are treated as:

- carrying on the activity carried on by the LTC;
- holding the property that the LTC holds;
- being party to any arrangements to which the LTC is a party; and
- doing and being entitled to do all the things the LTC does or is entitled to do (s HB 1).

63. To that end, the shareholders in an LTC are treated as receiving all income and incurring all deductions personally. Given all income of an LTC is treated as being derived personally by its shareholders, distributions from the LTC to its shareholders

are ignored for tax purposes. LTCs are also excluded from the definition of "company" in s YA 1, excluding them from the application of the dividend rules.

64. Shareholders are, however, entitled to a deduction for their share (based on their effective look-through interest) of any payments made to a working owner of the LTC (s DC 3B(1)). A "working owner" is a person who is an owner of the LTC who personally and actively performs duties that are required to be performed in carrying on the business of the LTC and are performed by the person under a contract of employment (s YA 1). The contract of employment must be in writing and must specify the terms and conditions of the services to be performed by the working owner and the amount payable for the performance of those services (s DC 3B(3)). An LTC cannot have a working owner, if the LTC is wholly or mainly engaged in investing money or in holding, or dealing in, shares, securities, investments or estates and interests in land.

65. Example 19 and Example 20 show how distributions are taxed under the LTC rules.

**Example 19 – Distribution from an LTC**

Chen is a shareholder in Chen's Hens Ltd, which is an LTC. Chen receives a distribution of $100 from Chen's Hens Ltd.

The distribution is ignored for tax purposes. Instead, Chen is taxed on his share of Chen's Hens Ltd's income as if he derived it directly.

**Example 20 – Working owner**

Kyle is a shareholder in Kyle's Smiles Ltd, which is an LTC. Kyle performs services for Kyle's Smiles under a contract of employment, which specifies the duties he is required to undertake and his salary.

Kyle's salary is a deductible expense for Kyle and the other shareholders in Kyle's Smiles Ltd.

# Qualifying companies

66. While it is not possible for a company to elect to become a qualifying company anymore, qualifying companies still exist. Any dividend paid by a qualifying company to a person resident in New Zealand is exempt income of the person to the extent to which it is more than the fully imputed distribution (ss HA 14 and CW 15). Imputation credits are automatically treated as being attached to any dividend that is not a non-cash dividend (other than taxable bonus issues) to the extent that imputation credits

are available (calculated at the end of the tax year) (s HA 15). Example 21 illustrates this.

### Example 21 – Dividend from a qualifying company

Angelina is a shareholder in Angelina's Ballerinas Ltd, which is a qualifying company. Angelina's Ballerinas Ltd makes a distribution to Angelina of $100 during the 2021 tax year. Angelina's Ballerinas Ltd has $28 of available imputation credits at the end of the 2021 tax year.

The distribution is treated as an imputed dividend to the extent of the available imputation credits (that is, $72). The remaining distribution is exempt income for Angelina.

## More examples

### Example 22 - Overdrawn shareholder loan account

Alex is a shareholder in Alex's Axolotls Ltd. Alex is not an employee. On 14 June 2020, Alex borrows NZ$1,000, interest free, from Alex's Axolotls Ltd.

On 31 December 2020, Alex's Axolotls Ltd pays Alex a fully imputed dividend of $200 (gross dividend of $277.78 including imputation credits of $77.78) that is applied to repay part of the loan. Because the repayment is made in the same year that the loan was provided, Alex is treated as having made the repayment on the day the loan was originally made, and any dividend arising from the fact the loan was interest free will reduce accordingly.

When preparing the monthly management accounts for Alex's Axolotls Ltd in March 2021, its accountant notes that Alex's loan account is still outstanding and that there is the potential for a non-cash dividend to arise:

| **Shareholder loan account – Alex** | | | | |
|---|---|---|---|---|
| Date | | Debit | Credit | Balance |
| 1/4/20 | Opening balance | | | 0.00 |
| 14/6/20 | Loan to Alex | | 1,000.00 | 1,000.00 |
| 31/12/20 | Dividend | 200.00 | | 800.00 |

The accountant advises the directors that they have some options in terms of dealing with the tax consequences of Alex as receiving a non-cash dividend. The first option is that Alex is treated as deriving a non-cash dividend. The amount of the non-cash dividend is calculated on the outstanding balance of the loan, allowing the fully imputed dividend to be credited against the loan on 14 June 2020, the date the loan was drawn down.

$$Deemed\ dividend = Outstanding\ loan\ x\ interest\ rate\ x\ \frac{days\ in\ quarter}{365}$$

$$Non - cash\ dividend\ Q1 = \$800\ x\ 5.26\%\ x \frac{16}{365}$$

$$Non - cash\ dividend\ Q1 = \$1.84$$

$$Non - cash\ dividend\ Q2 - Q4 = \$800\ x\ 4.5\%\ x \frac{274}{365}$$

$$Non - cash\ dividend\ Q2 - Q4 = \$27.02$$

$$Total\ non - cash\ dividend = \$28.87$$

Under option 1, Alex would be treated as deriving a dividend of $28.87 on the earlier of 30 September 2021 or when notified by Alex's Axolotls Ltd of the payment of the dividend. Because the accountant is preparing the accounts soon after balance date, this dividend could have imputation credits attached to it like the earlier dividend did (attaching imputation credits is discussed from [43]).

The accountant advises that option 2 is to charge Alex interest on the loan in the amount of $28.87 to 31 March 2021. This would increase the balance of the loan to $828.87 as at that date. In Alex assuming liability for this further amount, the value of the non-cash dividend would be reduced to nil.

Alternatively, the accountant advises Alex's Axolotls Ltd that as it has had a very successful year, it could just pay Alex a further dividend of $800. This dividend could be declared and paid by 31 March 2021. It could be imputed and credited back to the date the loan was drawn down.

### Example 23 – FBT rules apply

Jon is a shareholder and employee of Jon's Jeeps Ltd. Jon's Jeeps Ltd allows Jon to use one of its vehicles for his private purposes. Jon does not make any payment to Jon's Jeeps Ltd in exchange for the use of the vehicle.

*Is there a transfer of value?*

Yes - Jon's Jeep Ltd has transferred value to Jon by allowing him to use one of its vehicles without requiring any payment in exchange.

*Was the transfer caused by a shareholding?*

Potentially – Jon's Jeeps Ltd would not allow a person unconnected with the company to use its vehicles. Given Jon is a shareholder in Jon's Jeeps Ltd the transfer of value could be caused by the shareholding.

*Do any of the exclusions apply?*

Yes – Given Jon is also an employee of the company, the private use of the vehicle would also be subject to the FBT rules. Private use of a vehicle is not an unclassified benefit.

Therefore, the benefit would be subject to FBT and not be taxed as a non-cash dividend under s CD 32.

### Example 24 – FBT rules apply

Angie is a shareholder and employee of Angie's Apricots Ltd. Angie's Apricots allows Angie to take an amount of apricots home with her each night as a supplement to her salary.

*Is there a transfer of value?*

Yes – Angie's Apricots Ltd has transferred value to Angie by providing her with apricots free of charge.

*Was the transfer caused by a shareholding?*

No – Angie has been provided with the apricots as a supplement to her salary. The apricots have been provided as payment for her services and not because she is a shareholder in the company.

Therefore, no non-cash dividend will arise.

*FBT consequences*

However, the provision of apricots to Angie in connection with her employment will give rise to an unclassified fringe benefit, such that FBT will be payable by Angie's Apricots Ltd based on the market value of the apricots provided.

# References

## Legislative references

Income Tax Act 2007 – ss CB 1B – CB 1E, subpart CD (ss CD 4 – CD 7, CD 7B, CD 8, CD 11, CD 20, CD 22, CD 23, CD 23B, CD 24 – CD 29, CD 31, CD 32, CD 38 – CD 42), ss CE 1, CE 2, CE 5, CW 15, CX 2, CX 3, CX 6, CX 9, CX 10, CX 12, CX 13 – CX 18, Part D (ss DA 1, DB 1, DC 3B), GB 1, GB 23, GB 25, HA 14, HA 15, HB 1, OB 60, RD 26, RD 41, RD 54, YA 1 ("effective look-through interest", "working owner")

## Case references

*Abbott v Philbin (Inspector of Taxes)* [1960] 2 All ER 763 (HL)

*Campbell v CIR* [1968] NZLR 1 (HC)

*Case V9* (2001) 20 NZTC 10,101 (TRA)

*Christchurch Press Co Ltd v CIR* (1993) 15 NZTC 10,206

*Dawson v CIR* (1978) 3 NZTC 61,252 (SC)

*Heaton (Inspector of Taxes) v Bell* [1969] 2 All ER 70 (HL)

*Mersey Docks and Harbour Board v Lucas* (1883) 8 AC 891, (1883) 2 TC 25 (HL)

*Stagg v CIR* [1959] NZLR 1,252 (HC)

*Tennant v Smith* (1892) 3 TC 158 (HL)

## Other references

"Deemed dividends", *Public Information Bulletin* 125 (March 1984): 6.

"QB 14/09: Income tax – meaning of 'excessive remuneration' and 'excessive profits or losses' paid or allocated to relatives, partners, shareholders or directors", *Tax Information Bulletin* Vol 26, No 9 (1 October 2014): 22. https://www.taxtechnical.ird.govt.nz/tib/volume-26---2014/tib-vol26-no9

# About this document

Interpretation Statements set out the Commissioner's views and guidance on how New Zealand's tax laws apply to specific situations. While they set out the Commissioner's considered views, Interpretations Statements are not binding on the Commissioner.

However, they can generally be relied on by taxpayers in determining their tax affairs. See *Status of Commissioner's advice* (December 2012).